

STATEMENT OF THE HONORABLE JOHN A. GAUGHAN, MARITIME
ADMINISTRATOR, DEPARTMENT OF TRANSPORTATION, BEFORE THE
SUBCOMMITTEE ON MERCHANT MARINE OF THE SENATE COMMITTEE ON
COMMERCE, SCIENCE, AND TRANSPORTATION, WITH RESPECT TO
S. 1993, A BILL "TO PRESERVE THE RIGHTS OF CERTAIN PARTIES
WITH AN INTEREST IN AIRCRAFTS, AIRCRAFT PARTS, OR VESSELS,
AND FOR OTHER PURPOSES."

MARCH 21, 1986

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE ON
MERCHANT MARINE. MY NAME IS JOHN A. GAUGHAN, AND I AM THE
MARITIME ADMINISTRATOR OF THE DEPARTMENT OF TRANSPORTATION.
IT IS A PLEASURE FOR ME TO APPEAR THIS MORNING IN SUPPORT OF
THE ADMINISTRATION'S PROPOSED LEGISLATION TO AMEND THE
BANKRUPTCY LAWS.

MY TESTIMONY THIS MORNING WILL BE LIMITED TO S. 1993,
WHICH WOULD AMEND CHAPTER 11 OF THE BANKRUPTCY CODE TO
PROVIDE A PARTIAL IMMUNITY FROM THE AUTOMATIC STAY TO
CREDITORS WITH PREFERRED SHIP MORTGAGES. THE WITNESS FROM
THE DEPARTMENT OF COMMERCE WILL ADDRESS PROBLEMS THAT ARE
ENCOUNTERED UNDER THE TITLE XI FISHERIES GUARANTEE PROGRAM
MANAGED BY THAT DEPARTMENT.

PURSUANT TO THE GUARANTEE PROGRAM AUTHORIZED BY TITLE
XI OF THE MERCHANT MARINE ACT, 1936, THE SECRETARY OF
TRANSPORTATION HAS BEEN AUTHORIZED TO GUARANTEE OBLIGATIONS

SOLD IN THE PRIVATE MARKET TO FINANCE OR REFINANCE THE CONSTRUCTION, RECONSTRUCTION OR RECONDITIONING OF U.S.-FLAG VESSELS IN DOMESTIC SHIPYARDS.

ALL GUARANTEE FEES AND RECEIPTS UNDER THE TITLE XI PROGRAM ARE DEPOSITED INTO A FEDERAL SHIP FINANCING FUND, WHICH WAS INTENDED TO SUSTAIN THE TITLE XI PROGRAM. IN THE EVENT OF A SHIPOWNER DEFAULT ON PAYMENT OF TITLE XI DEBT, THE GOVERNMENT MUST HONOR ITS GUARANTEE AND PAY THE BONDHOLDERS OR NOTEHOLDERS IN FULL. IF THE FUND IS EXHAUSTED, THE SECRETARY IS AUTHORIZED TO BORROW MONEY DIRECTLY FROM THE U.S. TREASURY TO PAY OFF ON DEFAULTS.

PRIOR TO FISCAL YEAR 1983 THE TITLE XI PROGRAM EXPERIENCED ONLY OCCASIONAL SMALL DEFAULTS, DESPITE THE CYCLICAL NATURE OF THE SHIPPING INDUSTRY. IT NOW SEEMS CLEAR THAT WE ARE NOT IN THE MIDDLE OF A NORMAL CYCLICAL SHIPPING DOWNTURN BUT RATHER OF THE LONGEST SUSTAINED MARITIME RECESSION IN 50 YEARS. THE ECONOMIC RECESSION IN THE INLAND, OFFSHORE SUPPLY AND DRILLING INDUSTRIES IS EXPECTED TO CONTINUE, AS LONG AS WORLD CRUDE OIL PRICES ARE DEPRESSED.

THE CONSEQUENCE OF THIS ABNORMAL CYCLE HAS BEEN AGGREGATE TITLE XI DEFAULTS IN FISCAL YEAR 1983 OF \$91.2 MILLION, IN FISCAL YEAR 1984 OF \$101.3 MILLION, IN FISCAL YEAR 1985 OF \$320.8 MILLION. TO DATE IN FISCAL YEAR 1986 TITLE XI DEFAULTS HAVE AGGREGATED \$659.6 MILLION. THE RESERVES IN THE FEDERAL SHIP FINANCING FUND WERE EXHAUSTED IN FISCAL YEAR 1985 AND WE HAVE SINCE BORROWED \$795 MILLION

FROM THE U.S. TREASURY TO COVER THESE LOSSES. WE EXPECT THAT AGGREGATE BORROWINGS FROM THE TREASURY COULD RISE TO \$1 BILLION OR MORE IN THE NEXT SEVERAL MONTHS. THE PRESENT OUTSTANDING TITLE XI PORTFOLIO IS APPROXIMATELY \$6 BILLION. WHILE ANY PROJECTION OF "RECOVERY" FROM THIS CURRENT UNPRECEDENTED CYCLE IS EXTREMELY HAZARDOUS, WE EXPECT THAT BY THE BEGINNING OF NEXT YEAR, THE TITLE XI PORTFOLIO SHOULD BE MORE MANAGEABLE WITHOUT THE KIND OF ONGOING LARGE DEFAULTS PRESENTLY BEING EXPERIENCED. HOWEVER, THE CONTINUING DECLINE IN OIL PRICES, ALREADY A MAJOR CAUSE FOR THE CURRENT SUSTAINED DOWNWARD CYCLE, COULD EXTEND THIS PROJECTION FURTHER INTO THE FUTURE.

MR. CHAIRMAN. THE CURRENT SITUATION IS VERY SERIOUS, AND ONE OF OUR MAJOR PROBLEMS IN MANAGING THE PROBLEM IS THE BANKRUPTCY LAW. IT PROHIBITS US FROM FORECLOSING ON THE VESSEL USED AS SECURITY FOR THE TITLE XI DEBT. THIS WOULD APPEAR TO RESULT FROM A MISUNDERSTANDING WHEN THE BANKRUPTCY ACT (PUBLIC LAW 95 - 598) WAS REVISED IN 1978.

PRIOR TO THE 1978 BANKRUPTCY CODE, IN THE EVENT OF A TITLE XI DEFAULT BY A SHIPOWNER IN BANKRUPTCY, THE BANKRUPTCY COURT DID NOT HAVE THE STATUTORY AUTHORITY TO STAY THE SECRETARY FROM FORECLOSING ON THE VESSEL MORTGAGE OF THE DEBTOR SHIPOWNER IF THE SECRETARY DETERMINED THAT SUCH A FORECLOSURE WAS IN THE BEST INTEREST OF THE GOVERNMENT. THE REVISED BANKRUPTCY CODE DID NOT CONTINUE THE SECRETARY'S ABSOLUTE IMMUNITY FROM THE BANKRUPTCY STAY PROVISIONS. INSTEAD, THE SECRETARY AS WELL AS OTHER SECURED

CREDITORS WITH INTERESTS IN VARIOUS TYPES OF TRANSPORTATION EQUIPMENT WERE INTENDED TO HAVE A QUALIFIED IMMUNITY FROM THE STAY PROVISIONS UNDER SECTION 1110 OF THE BANKRUPTCY CODE. APPARENTLY INADVERTENTLY, THE CLASS OF VESSELS TO WHICH QUALIFIED IMMUNITY FROM THE STAY PROVISIONS APPLIED WAS LIMITED TO CERTAIN DOMESTIC/INLAND VESSELS REGULATED BY THE INTERSTATE COMMERCE COMMISSION (ICC).

UNFORTUNATELY, THE BULK OF THE VESSELS PRESENTLY COVERED BY TITLE XI GUARANTEES ARE NOT ICC-REGULATED INLAND AND DOMESTIC VESSELS. AS A RESULT, THE SECRETARY OF TRANSPORTATION IS EFFECTIVELY BLOCKED BY THE AUTOMATIC STAY PROVISIONS OF THE BANKRUPTCY CODE FROM FORECLOSING ON THE TITLE XI SECURITY AND MUST RESORT TO THE COSTLY, TIME-CONSUMING, AND ARDUOUS PROCEDURE REQUIRED TO SEEK RELIEF FROM THE BANKRUPTCY STAY.

SINCE THE ENACTMENT OF THE 1978 BANKRUPTCY CODE REVISION, THE DEPARTMENT HAS EXPERIENCED CONSIDERABLE FRUSTRATION IN REALIZING ON ITS COLLATERAL FOR THE TITLE XI DEBT BECAUSE OF THE AUTOMATIC STAY PROVISION. THE DEPARTMENT IS CURRENTLY PRECLUDED BY THE STAY OF VARIOUS BANKRUPTCY COURTS FROM FORECLOSING ON ASSETS THAT SECURE OVER \$400 MILLION IN DEFAULTED TITLE XI OBLIGATIONS, AN AMOUNT WHICH IS RISING WEEKLY. EXPERIENCE INDICATES PROBABLY TWO YEARS ON THE AVERAGE FOR CONTESTED CASES AT BEST BEFORE THE DEPARTMENT OBTAINS RELIEF FROM THE STAY ORDER OR AN AGREEABLE PLAN OF REORGANIZATION. EXPERIENCE ALSO SUGGESTS THAT BECAUSE OF THE GOVERNMENT'S INABILITY TO

FORECLOSE PROMPTLY, THE BANKRUPTCY COURTS WILL BE FILLED IN LARGE PART BY SHIPOWNERS WHOSE PRINCIPAL MOTIVATION IS TO KEEP THEIR TAX CREDITS FROM UNWINDING.

THE DELAYS IN FORECLOSING ON COLLATERAL VESSELS ALSO EXACERBATES AN ALREADY DEPRESSED MARKET, IN MANY CASES ALLOWING VESSELS TO FURTHER DEPRESS THE MARKETS BY OPERATING WITHOUT ANY CAPITAL COSTS. THE DELAY IN FORECLOSING MOREOVER LENGTHENS THE TIME FOR REPAYMENT TO THE FEDERAL TREASURY.

FINALLY, THE DELAY ADVERSELY AFFECTS THE FINANCIAL VIABILITY OF NONDEFAULTING OPERATORS. THE COMPANIES IN BANKRUPTCY, OPERATING WITHOUT SERVICING ANY CAPITAL DEBT, ARE IN A POSITION TO CUT RATES TO THE DETRIMENT OF THEIR COMPETITORS. THIS, IN TURN, ADDS TO THE THREAT TO THE CONTINUED VIABILITY OF THE NONDEFAULTING TITLE XI COMPANIES. IN MY OPINION, THE CURRENT FINANCIAL CRISIS IN MANY SECTORS OF THE MARITIME INDUSTRY IS, IN PART, A RESULT OF THIS UNEQUAL COMPETITION BETWEEN COMPANIES IN CHAPTER 11 BANKRUPTCY AND OTHER OPERATORS IN THE INDUSTRY.

TO OVERCOME THESE PROBLEMS, THE ADMINISTRATION HAS PROPOSED LEGISLATION THAT YOU INTRODUCED AS S. 1993. THE BILL WOULD AMEND SECTION 1110 OF THE BANKRUPTCY CODE TO PROVIDE A PARTIAL IMMUNITY FROM THE AUTOMATIC STAY TO CREDITORS WITH PREFERRED SHIP MORTGAGES. THE AMENDMENT TO SECTION 1110 WOULD BROADEN THE CLASS OF VESSELS INCLUDED WITHIN THE EXEMPTION TO ALL VESSELS POTENTIALLY COVERED BY TITLE XI GUARANTEES AND WOULD ESTABLISH PARITY WITH THE

GOVERNMENT'S AND PRIVATE LENDER'S PRESENT RIGHTS WITH REGARD TO LOANS TO AVIATION AND RAIL INDUSTRIES WHO HAVE THE SAME EXEMPTION. THE SHIPOWNER IN CHAPTER 11 BANKRUPTCY WHO HAS DEFAULTED ON ITS TITLE XI OBLIGATIONS WOULD BE ENTITLED TO CONTINUE TO USE ITS VESSEL OR VESSELS FOR 60 DAYS AFTER THE ORDER FROM RELIEF UNDER THE BANKRUPTCY CODE HAS BEEN ENTERED. THEREAFTER, SUCH CONTINUED USE WOULD BE PERMITTED ONLY IF THE DEBTOR CURES ITS OUTSTANDING DEFAULTS. THE AMENDMENT WOULD EXTEND THESE RIGHTS TO BOTH PRIVATE AND GOVERNMENTAL LENDERS, CONTINUING THE PRESENT PHILOSOPHY OF THE CODE OF TREATING GOVERNMENT AND PRIVATE CREDITORS ALIKE.

MR. CHAIRMAN. SECTION 1110, AS AMENDED BY S. 1993, WOULD NOT CONFLICT WITH THE SECRETARY'S OBLIGATION TO THE BONDHOLDERS OR NOTEHOLDERS UNDER THE TITLE XI GUARANTEE PROGRAM. IT WOULD, HOWEVER, CORRECT AN UNINTENDED PARTIAL OMISSION OF PORTIONS OF THE MARITIME INDUSTRY FROM QUALIFIED RELIEF FROM THE AUTOMATIC STAY PROVISION AND WOULD END A SITUATION THAT IS AGGRAVATING THE CURRENT RECESSION IN THE INDUSTRY. IT WOULD ALSO END A SITUATION THAT AS PRESENTLY CONSTITUTED IS UNFAIR TO THE GOVERNMENT AND THE AMERICAN TAXPAYER. THOSE WHO HONOR THEIR TITLE XI OBLIGATIONS HAVE TO COMPETE WITH THOSE WHO DO NOT. THE FORMER CANNOT LONG SURVIVE UNDER THAT COMPETITION. THE GOVERNMENT'S PRESENT RECOURSE IS TO PAY OFF IN FULL ON ITS OBLIGATION AND PURSUE YEARS OF LITIGATION. IN THE MEANTIME THE FEDERAL DEFICIT CONTINUES TO GROW SO THAT ALL TAXPAYERS ULTIMATELY FINANCE THE PRESENT SCHEME.

MR. CHAIRMAN. THAT CONCLUDES MY PREPARED STATEMENT.
I WILL BE PLEASED TO ANSWER ANY QUESTIONS THAT YOU OR THE
MEMBERS OF THE SUBCOMMITTEE MAY HAVE. THANK YOU.